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FEDERAL COMMUNICATIONS COMMISSION
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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Price Cap Performance Review for Local Exchange Carriers	)	CC Docket No. 94-1
	)	

COMMENTS OF TELEPORT COMMUNICATIONS GROUP INC.

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SUMMARY

The Commission's Notice, which seeks comment on whether to lessen its regulation of the traditional Local Exchange Carriers, errs in confusing the existence of local competitors with the existence of local competition. Competitors we have, competition we lack.

The Notice references "dramatic changes in telecommunications technology and markets" as justifying possible changes in regulation. But when looked at dispassionately, these "dramatic changes" are found either to be associated with the long-distance market and not the local market, or are just "possibilities" for competition that might (but might not) develop in the future. Today's reality is that 99.866% of AT&T's access services and 99.6% of MCI's access services are handled by LECs -- hardly a competitive marketplace.

And the marketplace will remain noncompetitive until three key prerequisites for local exchange competition are met. Local exchange competition must be legal -- at present it is only legal in three states, and there only recently. Local exchange competition must be operationally and technically feasible -- at present many of the essential interconnections have not been defined or agreed to. And finally, local exchange competition must be economically feasible -- at present that is something that frankly has yet to be demonstrated, much less shown to be sustainable.

These three tests should be the benchmark against which the Commission assesses any claims about competition. Any LEC claiming that it faces such serious competition that it requires price cap relief should be required to demonstrate that these three requirements have been met in its territory. Until and unless it is able to do so, claims that the market is competitive cannot be accepted.

In arguing that the local telecommunications market is competitive, the LECs often point to collocation as a central reason that they face competition. But collocation is not competition. Collocation does not permit a CAP to offer services in direct and complete competition with the LEC. Instead, collocation allows the CAP to be a reseller of the LEC's retail access services. Collocation does not show that CAPs are independent competitors of the LECs, but rather collocation shows just how dependent CAPs are on the LECs in order to reach customers. The reverse is not true -- LECs already reach every customer the CAPs serve -- and this fundamental asymmetry in the relative competitive posture of the CAPs and the LECs requires and justifies the asymmetrical regulation of the dominant LECs.

To the extent that changes are to be made in price cap regulation based on competition, the key issue is clearly defining what competition is and how it should be measured. TCG recommends that, once a LEC has demonstrated that the three prerequisites for local exchange competition are in place, the Commission should then look to the Horizontal Merger Guidelines used by the Department of Justice and the Federal Trade Commission. These provide a useful analytical approach for determining if a group of LEC-provided interstate services qualify for reduced or streamlined regulation. The merger guidelines (applied in the form of the "Herfindahl-Hirschman Index") are used to evaluate whether a proposed business combination will create a monopoly situation in a presently competitive market.

The concept can be applied "in reverse" to see if a previous monopoly market -- in this case local access -- has become sufficiently competitive to consider relaxing regulation of the monopoly. Applied in this fashion, current LEC markets are insufficiently competitive to justify reduced regulation.

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Teleport Communications Group, Inc. ("TCG") offers the following comments in response to the Commission's Notice of Proposed Rulemaking ("Notice") in the above matter.[1]

INTRODUCTION

The Commission's Notice seeks comments on whether changes in price cap regulation are necessary due to changes in circumstances in the three years that such regulation has been in force. The primary reason that the Commission believes such changes may be called for is what it perceives to be an increasingly competitive landscape in local telecommunications. While TCG would certainly agree that there are more competitive local carriers than when LEC price caps were first adopted, the Commission must not make the mistake of confusing the existence of competitors with

[1] Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, FCC 94-10, released February 16, 1994.

the existence of competition. Competitors we have, competition we lack.

The Notice, at its very outset, provides evidence that this is so. The Notice states that the last few years have led to "dramatic changes in telecommunications technology and markets" and references the Open Network Architecture tariffs, expanded interconnection, 800 data base technology, video dialtone, and the allocation of spectrum for wireless Personal Communications Services as examples of such dramatic changes.[2]

But the reality is quite different -- as even a cursory review of the Commission's "dramatic changes" would confirm. Most observers would agree that the FCC's Open Network Architecture tariffs have been largely unsuccessful, of interest only to enhanced service providers which do not provide local services, and of limited interest even to them. The FCC's expanded interconnection tariffs are still under investigation, still contain excessive rates and unreasonable terms and conditions, have been challenged as unconstitutional by the LECs, and in any event only address competition for specialized high capacity services chiefly used by the interexchange carriers. The FCC's efforts on 800 data base competition, while successful, have nothing whatsoever to do with local competition. Video dialtone also has nothing to do with local telephone competition --

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[2]Notice at Paragraph 3.

it relates to LECs competing with cable companies, not new entrants competing with LECs. And the allocation of spectrum for PCS also has had no impact thus far on local competition -- it merely presents a possible future source of competition for the LECs, not competition in the here and now which demands changes in price cap regulation. Accordingly, while the Commission and other parties may reference a variety of events and activities that might bear tangentially, or eventually, on the development of local competition, the reality is that local competition is not here.

In the following pages, TCG responds to many of the questions posed by the Commission in the Notice.[3] We demonstrate that the state of local competition does not justify any changes today in price cap regulation.

COMMENTS ON GENERAL ISSUES

General Issue 1: *Should the Commission revise the goals of the LEC price cap plan so that the plan may better achieve the purposes of the Communications Act and the public interest, and if so what should be the revised goals?*

The present goals of the price cap plan -- just, reasonable and nondiscriminatory rates, high quality services, and innovation -- are certainly laudable.[4] All of

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[3]TCG offers comments on selected issues raised in the Notice. TCG may offer reply comments on the other issues upon which it offers no initial comments herein.

[4]Notice Paragraph 31.

these goals can continue to be part of the framework of an appropriate price cap policy in the future.

TCG would suggest, however, that the Commission incorporate a new goal in its price cap plan. That goal would be that price cap regulation encourages the development of local telecommunications competition, and that price cap regulation not adversely affect the economic viability of local competition. Given that the development of a competitive marketplace in local telecommunications services is a goal of the Commission, as well as a goal of many state commissions, incorporating this as an explicit goal to guide the Commission's evaluation of changes to its price cap rules would be in the public interest.

General Issue 2. *What has been the effect of the price cap plan on consumer welfare, the economy, and the creation of jobs both in telecommunications and in other sectors of the economy.*

TCG believes that it will be difficult to ascribe with confidence any particular economic benefits to the implementation of price caps. While LECs have claimed that there are positive effects of price caps on consumer welfare, the national economy, and job creation, all these claims are largely subjective or anecdotal. What can be stated with more certainty is that price caps has certainly not stood as a barrier to the exercise of market power by the LECs, and their market dominance has not decreased under price caps.

By any measure, LECs retain tremendous market power. While the Competitive Access Provider ("CAP") industry, collectively, has yet to earn a profit, the profits of the local exchange carriers increased during the price cap era.[5] The LECs have achieved these rising profits even while sharply cutting the prices of the services where they face what little competition that exists -- the high capacity (DS1 and DS3) market.[6] This suggests the presence of considerable market power by the LECs. It also suggests that the price cap system does not inhibit the LECs in exercising that power.

It defies basic economic principles that these profits came from the few services that face competition. For example, figures developed by Bellcore from data provided by the Regional Bell Operating Companies and published by the United States Telephone Association ("USTA") indicate that, in aggregate, the LECs' private line and Special Access services are priced below cost.[7] The LECs must have earned considerable profits on their less competitive services, either by cutting costs and reducing service quality or by

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[5]Notice at Paragraph 26.

[6]Notice at Paragraph 25.

[7]See, USTA Potential Impact of Competition on Residential and Rural Telephone Service, July 21, 1993 (indicating that intrastate private line services are priced $800 million below cost, while interstate and intrastate Special Access services are only $400 million above cost, for a net loss on all private line type services of $400 million.)

increasing their rates. Tremendous market power allows them to engage in such anti-competitive and anti-consumer practices.

These facts show that the price cap system is not sufficient in neutralizing the LECs' market power. Moreover, it indicates that the LECs need no additional pricing flexibility.

COMMENTS ON BASELINE ISSUES

Baseline Issue No. 1a *- How can the facilities of the network be made available to all users, including suppliers of other telecommunications services and to other businesses that can improve their productivity by greater use of this infrastructure. Should the Commission revise the LEC price cap plan to support the development of a ubiquitous national information infrastructure.*

The development and deployment of a ubiquitous national information infrastructure depends on the development of competition. As the Commission points out, LECs have accelerated their deployment of digital switches, ISDN and optical fiber during the last four years.[8]

While some might claim that the price cap plan provided the LECs sufficient flexibility to deploy this technology, the threat of competition was the true incentive for these deployments. Indeed, many "new" LEC services are merely competitive reactions to services that CAPs have introduced into the marketplace. In New York, for example, TCG was the

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[8]Notice at Paragraph 29.

first company to offer DS3 services, only to be followed by New York Telephone with its own DS3 offering. CAPs have pioneered the use of fiber optic "rings" in order to provide redundant, alternately routed services, concepts which LECs like Southwestern Bell have copied in their Special Access services.

Because CAPs have deployed state-of-the-art networks in the territories of every Regional Bell Operating Company, and will continue to do so if given the chance, there already exists a marketplace incentive for LECs to improve the national information infrastructure. Granting the LECs additional pricing flexibility, beyond the considerable flexibility that the LECs already have, would simply risk destroying the very competition that will guarantee the efficient and ubiquitous deployment of the national information infrastructure.

Baseline Issue No. 1b. *Is the goal of universal service to all geographic areas and of equal type an quality for all Americans at affordable prices being met, or should we revise the LEC price cap plan to ensure the provision of universal service.*

As the Commission points out, the goal of universal service has largely been attained in most areas of the country.[9] Among the poor, however, and among certain communities that are isolated either due to geography or

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[9]Notice at Paragraph 29.

economics, universal service remains an elusive goal. The solution to this problem, however, does not lie in modifying the common line price cap basket. This basket represents a small portion of the total costs of local service. The Commission has already instituted a Lifeline program which permits carriers to reduce the subscriber line charge for eligible customers. Finally, the Commission has before it a variety of petitions addressing one or more aspects of the universal service issue. TCG therefore does not believe that there is any need to modify its price cap treatment of carrier common line costs.

The key to advancing universal service is not to be found in "fiddling" with the price cap rules for carrier common line costs, but with a fresh perspective and new approach to universal service. Reliance upon one carrier to provide universal service or to act as the carrier of last resort is ill suited to the competitive telecommunications future. Furthermore, asking other carriers to subsidize the LECs is also anticompetitive. Competition for customers will advance the goal of universal service efficiently and effectively.

TCG recommends that current universal service programs be replaced by a new plan that relies upon competition to serve all customers, subsidized and unsubsidized. Such a plan is based on the complete implementation of interconnection arrangements (TCG's Nine Points). TCG has published an outline of the universal service concept in the policy paper "Universal Service Assurance: A Concept for Fair Contribution and Equal Access to Subsidies." The concept described in that paper contains three basic tenets: (1) an explicit subsidy fund is managed by an independent administrator; (2) all carriers have equal access to the subsidy fund for serving subsidized customers; (3) each carrier contributes to the subsidy fund according to its share of the market. A copy of TCG's paper is attached.

Baseline Issue 1c. *We request that interested parties submit data and analysis regarding the rate at which price-cap LECs are replacing copper wire with fiber optic cable and increasing the bandwidth capacity of copper wires with signal compression techniques and other technologies.*

TCG has no information regarding the deployment of fiber optic and high-bandwidth technology by the LECs.

Baseline Issue No. 2 *- [W]hether current or revised price cap baskets and bands would reflect expected levels of competition for LEC interstate services, or other relevant common characteristics. For example, we request information and comment on whether differences in pricing behavior within and among baskets evidences different levels of competition.*

TCG believes that the current price cap baskets and bands are reasonably appropriate. To the extent that changes are to be made based on competition, the key issues are first, clearly defining what competition is and how it should be measured, and second, determining what price cap changes (if any) are appropriate in light of that competition.

With respect to the first issue, the Commission should not base LEC pricing flexibility and regulatory streamlining on "expected" levels of competition. Instead, the Commission should institute regulatory changes only when actual, measurable market changes justify such revisions.[10] The Commission applied such a standard in establishing price cap rules for AT&T. It first assigned AT&T's services to baskets and subjected them to price cap regulation. Services in two of the baskets initially placed under price caps were later moved from price caps into streamlined regulation, as the services were found to be effectively competitive. The levels of actual competition experienced by AT&T before its services were granted reduced regulation, however, are orders of magnitude greater than any competition experienced by the LECs to date.

Assuming, however, that a degree of competition in certain markets was detected, the next question is what changes, if any, should be implemented in price cap regulation. As an initial matter, the Commission should establish the price cap changes necessary to protect developing competition from anticompetitive LEC pricing practices. History shows that the FCC has had little if any

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[10]TCG discusses the standards for measuring local competition in response to Transition Issue 1b infra.

success in policing LEC pricing abuses through traditional "cost of service" analysis and regulation. Instead, the Commission should rely on imputation and price cap pricing restrictions to discourage LECs from undertaking anticompetitive pricing strategies. Accordingly, in the event that a degree of competition was detected in a particular market, the Commission's first action should be to put in place price cap rules to inhibit LECs from cross subsidization of unreasonably low rates in that market. Only when competition reaches the levels that AT&T experienced when the Commission deregulated its services will it become appropriate for the Commission to consider additional flexible regulation of LECs.

Baseline Issue No. 8a. *Whether the LEC price cap new services requirements impose unnecessary regulatory impediments to the development and introduction of new services, with specific identification of what those impediments are and an assessment of their magnitude.*

The Commission's price cap requirements for new LEC services do not impose unnecessary regulatory requirements. TCG is unaware of any new LEC service that has not been offered because of price cap restrictions. These requirements do, however, help to prevent cross-subsidization or discrimination. Because the LEC's new interstate services utilize their existing networks, cost support review is essential to ensure that services cover their relevant share of costs.

LECs sometimes claim that the 45-day notice period inhibits their ability to compete. TCG sees the 45-day notice period as necessary in that it gives the Commission and interested parties the ability to analyze the new service to determine first if it actually is a "new" service, second that is in the public interest, and third if it raises any policy issues. A reduction in this necessary review period would allow "new" services to go into effect without the proper scrutiny, and once in operation, it will be difficult for the FCC and the LEC to unravel any mistakes.

TCG finds it hard to believe that, for a truly "new" service, a 45 day waiting period should cause any impediments. If a service is truly new and innovative, a competitor would be unlikely to be able to respond to it in only 45 days -- but if a competitor could do so that probably indicates that the "new" LEC service is not very new after all. Moreover, market research, product development and roll out, internal provisioning efforts, and billing system upgrades all require time to plan and implement. A LEC should be able to coordinate a tariff filing with a 45-day cycle into their overall planning efforts. Accordingly, TCG sees no need for changes in the current treatment of new services under price caps.[11]

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[11]TCG therefore has no further comment on Issues 8b and 8c.

Baseline Issue No. 9a: *Whether our current rules for computing AT&T's exogenous access costs should be revised to equalize our treatment of LEC and CAP access rates in the calculation of AT&T's exogenous costs.*

Today, 99.866% of AT&T's access services and 99.6% of MCI's access services are provided by the LECs, according to those carriers. Under such circumstances, equalization of the treatment of dominant LEC and CAP access rates would serve no purpose: the impact of CAP services on AT&T's prices would be so small as to be irrelevant -- it would literally be lost in the rounding.

Additionally, CAP prices are aligned with LEC prices due to the LEC's market power. As LEC prices change, CAP prices must follow. Accordingly, when computing index changes in response to LEC price changes, AT&T would indirectly incorporate the matching price changes that CAPs would implement in response. Therefore adding specific separate treatment of CAP prices would be unlikely to have any material effect on AT&T's indexes.

While separate treatment of CAP revenues would have no material effect on AT&T's price caps, it would have a materially adverse impact on CAP business. If AT&T were required to undertake numerous and complex adjustments in its price cap indices simply to reflect its usage of CAP services, this creates a disincentive to use CAP facilities. AT&T would obviously have to develop and deploy a variety of tracking systems in order to collect CAP revenues (possibly separately by class of service), and then would incur the expenses of computing additional price cap indices. This would create an impediment to AT&T's use of CAP services, seriously hindering the development of competition. CAPs currently face enough difficulties and hurdles in selling services to IXCs. This Commission should not add to the CAPs' burdens by imposing separate treatment of CAP revenues.

Baseline Issue 9b. *Whether any other rules or policies that relate to LEC price cap regulation should be revised to equalize our treatment of LECs and CAPs, and if so, what the revised rules and policies should be.*

No rules or policies need to be changed to "equalize" the FCC's treatment of CAPs and LECs. Until local competition is technically and operationally feasible, legal, and economically viable -- and meaningful, the LECs require no regulatory relief. Indeed, the LECs have already received considerable regulatory relief, in the form of Zone Density Pricing, on the mere possibility of competition. Zone Density Pricing is in essence an "advance payment" on the prospect of increased competition -- a prospect that the LECs subsequently and effectively thwarted through excessive collocation prices, unreasonable collocation terms, and vigorous Court challenges to the Commission's policies.

While anecdotes about competition abound, and while LECs are fond of defining tiny markets and complaining about competition, the Commission cannot overlook the fact that LECs control in excess of 99% of the interstate access market of the two largest consumers of access, and probably control in excess of 99% of the total access market as well. At the time of divestiture, AT&T's competitors had a far larger share of the long distance market than the LEC's competitors have of the local market today, and yet divestiture was accepted as necessary by the Court. Under these circumstances, no one can seriously say that the LECs are facing levels of competition that require "equalization" -- although TCG is certain the LECs will uniformly claim that yes, indeed, they need help.

The price cap plan now in place is more than sufficient for the LECs to respond to the minimal amount of competition they now face. By any measure, the LECs possess overwhelming market power.[12] Indeed, the CAP industry's total market share is merely a fraction of the year to year growth in demand that the LECs experience. Moreover, the LECs continue to have a protected monopoly in the rest of

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[12] The Commission itself has identified one manifestation of that market power in paragraph 27 of the Notice: the number of residential service quality complaints increased and stayed high from 1991 to 1993. Because the LECs have yet to face competition in residential services, they risk little by providing less than perfect service to residential customers. The LECs, in effect can (and apparently do) subsidize the service quality of their competitive products with poor service quality of their monopoly customers. CAPs, on the other hand, cannot reduce the quality of service to any market or to any customer without risking the loss of that market or customer to the LEC or to another CAP.

their business, with the consequential opportunity for cross-subsidization and anticompetitive behavior that such a protected core market affords.

Equalizing the treatment of such unequal entities would only increase the LEC's power. The list of LEC advantages over CAPs is a long one, ranging from guaranteed revenue streams (even under price caps) and access to subsidy pools, to control of number resources and network databases. TCG described some of these advantages in a recent white paper, which is attached.[13] Such market asymmetry requires continued regulatory asymmetry, including price caps and other safeguards against LEC monopoly abuse.

COMMENTS ON TRANSITIONAL ISSUES

Transition Issue 1a: *What is the current state of competition for local exchange and interstate access?*

As has been noted in several of the questions above, the extent of local competition today is more illusion that reality. The two largest access customers use CAPs for less than 1% of their services. No CAPs have even been authorized to offer local exchange services, except in three states (New York, Washington, and Maryland), and there only quite recently. No CAPs are currently offering local

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[13] "The Unlevel Playing Field: Asymmetric Market Power Demands Asymmetric Regulation," TCG, March 1994.

exchange services in either state, since the operational, technical and economic prerequisites to such competition are not yet in place. By no means or measure can it be seriously contended that there is vigorous local exchange competition today.

Transition Issue 1b: *What criteria if any should be used for determining when reduced or streamlined regulation for price cap LECs should take effect?*

The Horizontal Merger Guidelines used by the Department of Justice and the Federal Trade Commission provide a useful analytical approach for determining if a group of LEC-provided interstate services should be allowed reduced or streamlined regulation.

The merger guidelines are used to evaluate whether a proposed business combination will create a monopoly situation in a presently competitive market. The concept can be applied "in reverse" to see if a previous monopoly market -- in this case local access -- has become sufficiently competitive to consider relaxing regulation of the monopoly.

Application of the Horizontal Merger Guidelines begins with the determination of the relevant market, followed by the evaluation of the level of market concentration, which is measured by the market shares of each participant in the market. The Herfindahl-Hirschman Index ("HHI") of market concentration is calculated by summing the squares of the individual market shares of all the participants. The degree of market concentration as measured by the HHI is broken into three categories: (1) unconcentrated (HHI below 1000); (2) moderately concentrated (HHI between 1000 and 1800); and (3) highly concentrated (HHI above 1800).

A highly concentrated market is viewed as giving its participants the ability to raise prices without customers having the ability to shift to a competitive provider. In the transition from monopoly to competition, a level of 1800 should be the benchmark that allows a LEC reduced regulation for a geographic area for a given product.

For example, a market area where the LEC has a 60% market share, one competitor has a 20% share, and two other competitors each have a 10% share would yield a HHI of 4200, and would be considered a highly concentrated market, and therefore not a candidate for relaxed treatment under HHI guidelines.

***Transition Issue 1b** (continued): (1) The nature and extent of any barriers to market entry and exit:*

CAPs face enormous barriers to entry. Barriers to expansion of competition for interstate special access and switched transport services include: (a) difficulties in obtaining rights of way; (b) limits on financing and capital; (c) discriminatory franchise fees;[14] (d) excessive collocation rates; (e) limits on the availability of collocation space; (f) high LEC termination liabilities that discourage customer choice; (g) high LEC rearrangement charges that make it prohibitively expense to change carriers; (h) LEC volume discounts that penalize customers from utilizing multiple suppliers; (i) high LEC term discounts that discourage free choice; (j) legal restrictions on competitors gaining authority to provide intrastate services, thereby preventing them from achieving network economics; (k) lack of availability of unbundled bottleneck components of local exchange networks, including number portability and cost-based loop services; and (l) lack of proven economic viability for local exchange services.

Additionally, the LEC's revenues from the interstate Residual Interconnection Charge, local switching element, and carrier common line charges constitute the bast majority of switched access revenues. These revenues will be secure from any competition until full local exchange competition becomes widespread, meaning that only a very small

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[14]This is an important issue. CAPs face substantial barriers in discriminatory franchise fees, which sometimes obligate CAPs to pay 5% of gross revenues to compete in a city, while the LEC pays nothing. This results in a 5% cost advantage for the LEC without regard to any operating efficiencies.

proportion of the total switched access market will even be open for competition in the foreseeable future.

Transition Issue 1b *(continued): (2) the existence of potential and actual competitors, and if so, what role should the existence of potential and actual competition play in determining whether to reduce or streamline LEC price cap regulation;*

It is not in anyone's best interest to base telecommunications policy on what "potentially" may happen. Much time and effort has been spent developing predictions (or outright guesses) about the shape of the future competitive marketplace, while current market realities are simply ignored. What should be relevant is the present. The present Competitive Access Industry is minute in terms of any rational indicator.

Local exchange carriers today control 99% of the access market, and even more of the local exchange market. The potential for competitive entry cannot be regarded as a significant or meaningful inhibitor of the behavior of an entity with 99% market shares and the protection of a host of operational, legal, and economic barriers to entry or effective competition. In analyzing the local exchange market, the Commission should look to its experience with the IXC industry, in which rational current market indicators were used to determine the level of competitiveness, not "tomorrow's technology". TCG proposes a rational, analytic approach, based upon established